

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Promoting Transmission Investment Through Pricing Reform) **RM06-4-000**
)

COMMENTS OF THE NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

Pursuant to P 74 of the Commission’s November 18, 2005 Notice of Proposed Rulemaking on *Promoting Transmission Investment Through Pricing Reform* (“NOPR”), the New York Independent System Operator, Inc. (“NYISO”) respectfully submits its comments in this proceeding. When Congress enacted the Energy Policy Act of 2005 and added new Section 219 to the Federal Power Act (“FPA”), it recognized the need for new policies that would encourage new transmission investments. The NYISO agrees that new incentives are appropriate and commends the Commission for moving so quickly to propose them. The NYISO strongly supports the NOPR’s overall policy direction and hopes that the Commission will promptly finalize new incentive rules that will help to reinforce transmission system reliability, provide a solid foundation for competitive electricity markets, and help to foster growth in all sectors of the economy.

Because the NYISO does not itself own or invest in transmission facilities, it is taking no position at this time on the NOPR’s specific rate proposals for transmission owners and investors. To the extent that the Commission entertains reply comments, the NYISO reserves the right to respond to other commenters on these issues.

Similarly, the NYISO takes no position on proposals aimed at stimulating the development of for-profit transmission companies (“Transcos”). The Commission should keep in mind, however, that although Transcos have enjoyed initial success in encouraging

investments, they are not the only vehicles for doing so. Well-designed, electricity markets employing a co-optimized bid-based economic dispatch built on locational marginal pricing, such as those that exist in the Northeast and Midwest, also encourage efficient investments in new transmission. Examples include the Cross-Sound Cable link between the New England and New York markets and the Project Neptune connection between New Jersey and New York. The Commission should continue to support such markets even as it promotes new Transcos.

On P 58, the NOPR requests comments on “whether and how performance-based regulation developed for for-profit entities might be applied to not-for-profit entities . . .” such as Independent System Operators and Regional Transmission Organizations (“ISOs/RTOs”). The NOPR suggests that performance-based regulation could encourage ISOs/RTOs to cut costs and improve efficiency. The NOPR goes on to express interest in “whether and how executive performance measures might be relevant, and whether and how performance might be benchmarked to that of for-profit entities or other not-for-profit entities.”¹

The NYISO respectfully submits that this proceeding is not the right forum for considering these questions. As an initial matter, this proceeding arises under FPA Section 219, which requires the Commission to develop “incentive-based (including performance-based) rate treatments for the transmission of electric energy in interstate commerce by public utilities for the purpose of benefiting consumers by ensuring reliability and reducing the cost of delivered power by reducing transmission congestion.”² Even assuming that performance-based rate mechanisms might reinforce ISO/RTO incentives to control their costs and operate efficiently, it is unclear how this proposal would influence transmission investments.

¹ NOPR at P 58.

² NOPR at P 1, *citing* new FPA Section 219.

The NYISO operates under a shared governance structure approved by the Commission. Its annual operating budgets and five-year targets are developed in detail through a collaborative process with the market participants. While the independent NYISO Board has the final budget approval, it has for the recent past done so without changing the nearly unanimous budget recommendations made by the NYISO stakeholders acting through the NYISO Management Committee.³ As a result of this close scrutiny and the NYISO's commitment to efficiency, the NYISO's operating costs are less than one percent of the more than eleven billion dollars of transactions it handled in 2005. Furthermore, the NYISO's costs are allocated between loads and supply in proportions voted for by the market participants who bear them and approved by FERC.

The NYISO supports the initiative already launched by the Commission to ensure that ISOs/RTOs continue to operate efficiently and are accountable to stakeholders, without compromising their independence. The first step in this process was the adoption of new accounting regulations better suited to ISOs/RTOs. These rules are scheduled to go into effect on an expedited basis early this year.⁴ The Commission previously said that it would follow up on the accounting rules with a comprehensive proceeding to fully explore ISO/RTO cost control

³ The 2006 and 2005 Budgets were approved by the Management Committee on November 9, 2005 (see www.nyiso.com/public/webdocs/committees/mc/meeting_materials/2005-11-09/motion_summary.pdf ["motion passed by majority show of hands with abstentions"]) and November 10, 2004 (see www.nyiso.com/public/webdocs/committees/mc/meeting_materials/2004-11-10/final_motions.pdf ["motion passed by majority show of hands"]), respectively.

⁴ See *Accounting and Financial Reporting for Public Utilities Including RTOs*, 113 FERC ¶ 61,276 (2005) ("Order No. 669"); *Notice Granting Motion for Extension of Time*, Docket No. RM04-12-000 (December 29, 2005).

and accountability.⁵ There have been a number of suggestions that the Commission would issue a new Notice of Proposed Rulemaking or Notice of Inquiry on these issues in the next few months.⁶ Accordingly, if the Commission wishes to explore the use of performance-based ratemaking mechanisms for ISOs/RTOs it would be more efficient, and less burdensome on interested parties, to do so in that proceeding.

In addition, as a practical matter, it will be difficult to develop successful policies in this area until the new accounting rules have been in place long enough to inform the inquiry. The information collected under the new accounting regime will make it easier to understand how well ISOs/RTOs are performing, to identify any problematic areas, and to evaluate which efficiency-enhancing steps already taken by ISOs/RTOs should be viewed as best practices. It will be much easier for the Commission to decide whether performance-based ratemaking is appropriate for ISOs/RTOs, and to design specific performance-based ratemaking rules, after information from the new accounting system becomes available. The same would be true of “benchmarking” proposals since it will be impossible to compare the costs and operating efficiency of different ISOs/RTOs without data collected under the new system.

If the Commission nevertheless decides to address performance-based ratemaking for ISOs/RTOs at this time, it should recognize that there are already numerous safeguards, including the fiduciary obligations of ISO/RTO directors and stakeholder oversight, which encourage

⁵ See, e.g., Order No. 669 at P 95 (“[C]ost oversight practices are an important aspect of the initiative we began with the NOI and we intend to address those matters in the near future.”); see also Federal Energy Regulatory Commission 899th Open Meeting, Remarks of Chairman Kelliher, Tr. at 41 (stating that cost oversight and management issues will be addressed in a separate proceeding).

⁶ See, e.g., Federal Energy Regulatory Commission 899th Open Meeting, Remarks of Commissioner Kelly, Tr. at 44 (anticipating that the Commission will take up RTO cost accountability sometime in 2006).

ISOs/RTOs to be efficient and accountable. The presence of these safeguards means that there is no immediate need for drastic change. The Commission can afford to take the time to evaluate different policy options and settle on the best one.

Furthermore, the Commission should adopt policies that support the independent Boards that govern ISOs/RTOs, rather than undermining their authority. To date, each ISO/RTO Board has created a management incentive plan to encourage and reward excellence. Similarly, each ISO/RTO Board has created budgeting procedures that provide for stakeholder involvement and address any special regional issues.⁷ Commission control over these areas would prevent Boards from establishing their own policies, depriving them of key management tools. There has been no showing that it is necessary for the Commission to displace ISO/RTO Boards in this way. It also appears that the Commission lacks authority make internal ISO/RTO management decisions.⁸

⁷ See *Comments of ISO/RTO Council on Notice of Inquiry*, Docket No. RM04-12-000, at p. 5 (Nov. 9, 2004) (explaining that the budgeting processes of ISOs and RTOs “have been developed to reflect regional differences and specific needs identified by stakeholders.”).

⁸ See *California Independent System Operator Corp. v. FERC*, 372 F.3d 395 at 403-04 (D.C. Cir. 2004) (emphasizing that the Commission does not have authority to make managerial decisions for public utilities, including ISOs/RTOs).

In conclusion, the Commission should press ahead with its effort to develop incentive rules to promote transmission investments. It should address ISO/RTO cost control and accountability issues, which are unrelated to transmission investment decisions, in a future proceeding.

Respectfully submitted,

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January 11, 2006

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